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No. 84-901

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

AVCO FINANCIAL SERVICES, INC.,
Petitioner,

v.

CLEVESTER DAVIS, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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MOTION OF THE AMERICAN FINANCIAL SERVICES ASSOCIATION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE, AND BRIEF OF AMICUS CURIAE

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MOTION OF THE AMERICAN FINANCIAL SERVICES ASSOCIATION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE IN SUPPORT OF THE PETITIONER'S POSITION

To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

The American Financial Services Association (AFSA) respectfully moves, pursuant to Rule 36 of the Rules of this Court, for leave to file the attached brief as *amicus curiae* in support of Petitioner's position. The Petitioner has consented to the filing of such brief. The Respondents have denied consent.

INTEREST OF THE AMERICAN FINANCIAL SERVICES ASSOCIATION

The AFSA is the nation's largest trade association serving the consumer finance industry. Organized in 1916, AFSA represents over 530 companies engaged in the extension of consumer credit throughout the United States. Virtually every AFSA member company extends consumer credit through a system of branch offices pursuant to state regulation and licensure.

AFSA members most commonly extend consumer credit, such as loans to finance the purchase of automobiles and applicances, home improvements, debt consolidation and for educational purposes. Branch office managers are responsible for the generation of new business, the implementation of a predetermined, independently verifiable credit scoring system used to evaluate loan applications, the collection of accounts and other matters related to the operation of a consumer loan office.

The decision in this case effectively renders any indirect participant in a securities transaction—including those who merely provide the financing for the transaction—liable under § 12(2) of the Securities Act of 1933 (15 U.S.C. 77*l*(2)). The decision places the Petitioner, and other AFSA members, under a duty to inquire about the nature of securities transactions and to evaluate the safety and soundness of securities investments.

Placed under a duty to investigate the safety and soundness of securities investments and to train and communicate with branch office personnel about securities matters, consumer finance companies may financially and effectively be prohibited from offering credit for such purposes. It is these companies which provide the small loan for the "first time" or infrequent investment made by homeowners and consumers.

AFSA is therefore concerned with the resolution presented in this case. The Petitioner has argued persua-

sively that there are direct and irreconcilable conflicts between the circuits and between the court of appeals decision and decisions of this Court.

At least six circuits provide divergent views of the issue raised in this case, rendering it virtually impossible for creditors who operate nationally to either understand their liability or to effectively prevent similar cases from arising.

The confusion and uncertainty of the decisions is mirrored by the uncertainty facing lenders which suddenly discover they are liable under Securities Act provisions, which were never anticipated and which impose upon the lenders and untrained branch personnel a duty to inquire with reasonable care into the nature of the investment.

WHEREFORE, it is respectfully requested that the Court grant the American Financial Services Association leave to file the attached brief as *amicus curiae* in support of the Petitioner's position.

Respectfully submitted,

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QUESTION PRESENTED

Whether a person who has not sold a security may be liable for the sale of that security under § 12(2) of the Securities Act of 1933?

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	v
TABLE OF AUTHORITIES	viii
INTRODUCTION	1
STATEMENT OF THE CASE	1
SUMMARY OF ARGUMENT	2
ARGUMENT	3
I. THERE IS DIRECT CONFLICT AND AN EXTREME DIVERGENCE AMONG THE CIRCUITS IN INTERPRETING PERSONS COVERED UNDER § 12(2)	3
II. THE COURT OF APPEALS DECISION CONFLICTS WITH DECISIONS OF THIS COURT, AND VIOLATES THE PLAIN LANGUAGE OF THE STATUTE AND THE CONGRESSIONAL INTENT	5
CONCLUSION	7

TABLE OF AUTHORITIES

CASES: Page

Aaron v. *SEC*, 446 U.S. 680 (1980) 5, 6
Blue Chip Stamps v. *Manor Drug Stores*, 421 U.S. 723 (1975) 5, 6
Canizaro v. *Kohlmeyer & Co.*, 512 F.2d 484 (5th Cir. 1975) 3
Collins v. *Signetics Corp.*, 605 F.2d 110 (3rd Cir. 1979) 3
Croy v. *Campbell*, 624 F.2d 709 (5th Cir. 1980) 3, 4
Davis v. *AVCO Corp.*, 371 F.Supp. 782 (N.D. Ohio 1974) 2
Davis v. *AVCO Corp.*, 739 F.2d 1057 (6th Cir. 1984) 2
Ernst & Ernst v. *Hockfelder*, 425 U.S. 185 (1976) 6
Feldman v. *Simkins Industries, Inc.*, 679 F.2d 1299 (9th Cir. 1982) 4
Hill York Corp. v. *American International Franchises, Inc.*, 448 F.2d 680 (5th Cir. 1971) 3
Lawler v. *Gilliam*, 569 F.2d 1283 (4th Cir. 1978) 3
Pharo v. *Smith*, 621 F.2d 656 (5th Cir. 1980) 3, 4
Santa Fe Industries, Inc. v. *Green*, 430 U.S. 462 (1977) 5
SEC v. *Murphy*, 626 F.2d 633 (9th Cir. 1980) 4
SEC v. *Sloan*, 436 U.S. 103 (1978) 5
Stokes v. *Lokken*, 644 F.2d 779 (8th Cir. 1979) 4
Touche Ross & Co. v. *Redington*, 442 U.S. 560 (1979) 5
Wasson v. *SEC*, 558 F.2d 879 (8th Cir. 1977) 4

FEDERAL STATUTES:

Securities Act of 1933, § 11, 15 U.S.C. § 77k ..... *passim*
Securities Act of 1933, § 12, 15 U.S.C. § 77*l* 2, 3, 4, 6
Securities Act of 1933, § 15; 15 U.S.C. § 77o ..... *passim*
Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) 2, 6

LEGISLATIVE HISTORY:

H.R. Rep. No. 85, 73rd Cong., 1st Sess. (1933) 6

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BRIEF AMICUS CURIAE OF THE AMERICAN FINANCIAL SERVICES ASSOCIATION IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The American Financial Services Association submits this brief, as *amicus curiae* in support of the Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit filed by the Petitioner Avco Financial Services, Inc.

STATEMENT OF THE CASE

This case arose as a result of a number of transactions made by the Toledo, Ohio office of AVCO Financial Services, Inc. (AVCO). In the normal course of consumer lending, beginning in February 1971, the Toledo office made loans to individuals purchasing shares of Dare To Be Great (DTBG), a pyramid investment sale operated with evangelical zeal by its promoters. In May 1971, DTBG personnel contacted the office manager and asked him to attend one of the promotional meetings, which he

did without offering any comments. In June 1971, the manager attended a second meeting and spoke to the audience about the AVCC application process and credit criteria.

During a routine examination by AVCO's district manager in July 1971, the Toledo office was instructed to cease making any further loans for the purpose of financing DTBG shares. As of that date, 48 loans had been made for such purposes. At no time during that period did AVCO's management have any knowledge of or relationship with DTBG, nor did it authorize or train its branch managers to give securities advice.

In 1974 the saturation point of DTBG sales was reached and the pyramid collapsed. Plaintiff and others of the 48 persons with loans written by AVCO, lost their investment and sued.

The case was decided by the U.S. District Court for the Northern District of Ohio, *Davis* v. *AVCO Corporation*, 371 F.Supp. 782 (N.D. Ohio 1974), and later appealed to the Sixth Circuit Court of Appeals, *Davis* v. *AVCO Corporation*, 739 F.2d 1057 (6th Cir. 1984). The opinions below held that (1) the AVCO branch manager was not guilty of any fraudulent intent and was taken in by the DTBG hoopla, (2) neither AVCO nor its branch manager had any knowledge of the untruths or omissions perpetrated by DTBG, and (3) neither AVCO nor its branch manager is liable under § 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)).

SUMMARY OF ARGUMENT

Amicus Curiae submits that the court of appeals decision in this case extends § 12(2) liability to a person who did not sell or offer a security, was not an agent of or controlled by the seller, did not act with scienter or recklessness, and was not employed or trained to deal in securities transactions. This result violates prior decisions of this Court and compounds the confusion occurring from diverse decisions by six circuits.

Amicus Curiae therefore urges this Court to grant the Petition for Writ of Certiorari in order to ultimately clarify this important point of law.

ARGUMENT

I. THERE IS DIRECT CONFLICT AND AN EXTREME DIVERGENCE AMONG THE CIRCUITS IN INTERPETING PERSONS COVERED UNDER § 12(2).

Section 12(2) of the Securities Act of 1933 provides that "any person who . . . offers or sells" a security by use of an untrue statement or omission of material fact is liable to "the person purchasing such security from him". (15 U.S.C. § 77*l*(2)).

Six circuits have interpreted the ambit of § 12(2). The Third Circuit held that the section was to be strictly construed to apply only to a claim by a purchaser against his immediate seller. *Collins* v. *Signetics Corp.*, 605 F.2d 110 (3rd Cir. 1979).

The Fourth Circuit has held that § 12(2)'s operative phrase "person who offers or sells" excludes persons who execute an unsolicted order or whose minor role in the transaction shows they have no causal connection with it. *Lawler* v. *Gilliam*, 569 F.2d 1283 (4th Cir. 1978).

The Fifth Circuit has said that it is clear that the term does not refer solely to those who pass title, *Canizaro* v. *Kohlmeyer & Co.*, 512 F.2d 484 (5th Cir. 1975), but also those persons whose offering or selling is a "substantial factor" in the purchaser's decision to buy. *Hill York Corp.* v. *American International Franchises, Inc.*, 448 F.2d 680 (5th Cir. 1971); *Pharo* v. *Smith*, 621 F.2d 656 (5th Cir. 1980).

More recently, the Fifth Circuit introduced a new "proximate cause" standard to determine whether a party is a "person who offers or sells" securities, stating, "[p]articipation in the sale of a security . . . is an im-

portant factor only as it relates to the concept of causation . . . we cannot say that the defendant's participation in this transaction proximately caused the plaintiffs' injury, or that they would not have purchased the security 'but for' his actions." *Croy* v. *Campbell*, 624 F.2d 709, 714 (5th Cir. 1980).

The Eighth Circuit has rejected both the broader participation theory followed by district courts in the Second Circuit and the Fifth Circuit's "proximate cause" test, holding "[w]e believe that one factor which ought to be considered in determining the 'sale' or 'offer to sell' issue is whether the defendant was uniquely positioned to ask relevant questions, acquire material information, or disclose his findings". *Wasson* v. *SEC*, 558 F.2d 879, 886 (8th Cir. 1977). More recently, the Eighth Circuit applied a substantial factor test in accord with the Fifth Circuit's *Pharo, supra*, decision. *Stokes* v. *Lokken*, 644 F.2d 779 (8th Cir. 1979).

The Ninth Circuit while at one time supportive of the substantial factor test in *SEC* v. *Murphy*, 626 F.2d 633 (9th Cir. 1980), returned to a privity test in *Feldman* v. *Simkins Industries, Inc.*, 679 F.2d 1299 (9th Cir. 1982).

In reaching its 2-1 opinion in this case, the court of appeals' decision adopts a new approach, which, it admits, "transcends the strict approach, is narrower than the formerly employed broad participation approach and different . . . than the aiding and abetting approach". (Petitioner's Brief for Certiorari at 15a). The court of appeals decision ennunciates a two-part test holding any person liable under § 12(2) if (1) his conduct is the "proximate cause" of the buyer's decision to purchase the security, and (2) if he is not successful in proving that he satisfied at least a five-part test of reasonable care. As dissenting Chief Judge Lively pointed out, "In my opinion, the majority has misread § 12(2) and reached the wrong result". (Petitioner's Brief for Certiorari at 24a).

The disparity between the circuits necessitates resolution by this Court. Corporations which operate nationally are severely burdened by the inconsistent application of this section causing their inability to uniformly manage any involvement in securities transactions. More importantly, the responsibilities and liabilities placed on national companies differ from jurisdiction to jurisdiction. Left untouched, the decsion of the court of appeals leaves securities professionals and those tangentially involved in securities transactions even more in doubt in the application of this law.

II. THE COURT OF APPEALS DECISION CONFLICTS WITH DECISIONS OF THIS COURT, AND VIOLATES THE PLAIN LANGUAGE OF THE STATUTE AND THE CONGRESSIONAL INTENT.

This Court has long reviewed securities laws by first analyzing the plain meaning of the statutory language. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977). In this case, the majority opinion may have started with the statutory language, but quickly discarded it, stating "[i]f we are limited to a literal reading of the statute, it is obvious that the plaintiffs here must fail, because AVCO was not in the literal sense the 'seller' of DTBG securities". (Petitioner's Brief for Certiorari at 12a).

Furthermore, on several occasions this Court has also looked beyond the plain meaning of statutory language of securities laws to determine Congressional intent and held that "generalized references to the 'remedial purposes' of the securities laws 'will not justify reading a provision more broadly than its language and the statutory scheme reasonably permit.'" *Aaron* v. *SEC*, 446 U.S. 680, 695 (1980); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 578 (1979); *SEC* v. *Sloan*, 436 U.S. 103, 116 (1978).

Here the court of appeals does not recognize the statutory scheme clearly intended by Congress in which Section 11 applies to signatories, directors, underwriters and experts; Section 12 applies to sellers; Section 15 to "controlling persons"; and Section 10(b) to "any person" as a catchall provision. This Court has noted the statutory design on many occasions. *Blue Chip, supra, Aaron, supra,* and *Ernst & Ernst* v. *Hockfelder,* 425 U.S. 185 (1976).

Following this Court's opinion in *Ernst & Ernst,* the court of appeals rightfully decided that the facts of this case did not satisfy the provisions of § 10(b) because of the branch manager's lack of knowledge of any fraud. The court then reached to the lesser burden of proof mandated under § 12(2) and found the Petitioner within the scope of "sellers" covered there. In light of the holding in *Ernst & Ernst,* it is irreconcilable that an indirect participant could be found not liable under § 10(b) because he lacked knowledge or the ability to obtain knowledge of the untruth or omission, but, on the other hand, could be found liable under § 12(2) because, without knowledge, he failed to act with reasonable care.

The result is that the court of appeals extends the standard of care required of "sellers" under § 12(2) to a new class of persons, namely lenders, lawyers and other indirect participants. Congress intended that the provisions of this section would apply to sellers in a position to know and disclose the material facts. "The committee has deemed . . . the burden of proof [of § 12] as both just and necessary, inasmuch as the knowledge of the seller as to any flaw in his selling statements . . are matters . . . to which the seller may readily testify . . ." H.R. Rep. No. 85, 73 Cong., 1st Sess. 23 (1933).

CONCLUSION

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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